Summary of Testimony of
Curt L. Hébert, Jr.
Chairman, Federal Energy Regulatory Commission
Before the Committee on Energy and Commerce
Subcommittee on Energy and Air Quality
United States House of Representatives
March 20, 2001

Wholesale and retail electricity markets in California and throughout much of the West are in a state of stress. Wholesale prices have increased substantially for a variety of reasons, consumers are constantly implored to conserve as much as possible, and utilities are facing growing financial problems. As a result, many now argue that we need to return to cost-based regulation, instead of relying on market-driven solutions.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices are sending the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices through regulation or legislation will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Federal Energy Regulatory Commission has been aggressively identifying and implementing market-driven solutions to the problems: (1) by stabilizing wholesale energy markets; (2) by adopting or proposing additional short-term and long-term measures that will increase supply and delivery infrastructure, as well as decrease demand; (3) by promoting the development of a West-wide regional transmission organization; and, (4) by monitoring market prices and market conditions.

Other regions that have not adopted California-type restrictions on electricity competition have demonstrated that consumers can and do gain from electricity competition and restructuring. California and Western consumers similarly can share in these gains, once market rules are in place that will make California and other Western states an attractive place for investment.

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I. Overview

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear here today to discuss the topic of electricity markets in California. Wholesale and retail electricity markets in California, and throughout much of the West, are in a state of stress. Wholesale prices for electricity have increased substantially for a variety of reasons in the last year. California power consumers face near-daily pleas to conserve. California load-serving utilities are under severe financial stress. Companies supplying wholesale power into California are unsure how much, or even whether, they will be paid for their supplies.

While the situation in California is not representative of other parts of the country that are successfully developing competitive markets, it nevertheless underscores the fundamental infrastructure problems facing the country. The demand for electricity continues to expand while supply fails to keep pace. The development and licensing of new hydroelectric capacity – which provides much of the existing power supply in the West – is nearly exhausted. Very little fossil-fired generation has been added in many regions of the country over the last few years, and in California no major plants have been added in the last decade. And the existing electric transmission grid is often fully loaded and, absent necessary expansion, is often incapable of delivering power to those regions where it is valued the most.

I would like to make three main points with respect to these problems and to identify the steps the Commission is taking to address these problems.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices are sending the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices artificially will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. California is not an island. It depends on generation from outside the State. The shortages and the prices in California have affected the supply and prices in the rest of the West. The Western transmission system is an integrated grid, and buyers and sellers need non-discriminatory access to all transmission facilities in the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Commission continues aggressively to identify and implement solutions to the problems:

- o **First**, in recent months, the Commission has issued a number of orders intended to restore market stability. The Commission has acted to move utilities out of volatile spot markets to enable them to develop a portfolio of risk reducing and creditworthy contracts.

- o **Second**, the Commission has recently adopted or proposed a range of additional measures that will increase supply and delivery infrastructure, as well as reduce demand for electricity in the Western Interconnection.

- o **Third**, the Commission is continuing to work with market participants on developing, as quickly as possible, a West-wide regional transmission organization. Such an organization will bring a regional perspective and offer regional solutions to regional problems.

- o **Fourth**, the Commission is monitoring market prices and market conditions with the goal of ensuring long-term confidence in Western markets. Moreover, the Commission's staff has proposed a new plan to monitor and, when appropriate, mitigate the price of electric energy sold in California's spot markets on a before-the-fact basis, instead of addressing prices through after-the-fact refunds. The Commission intends to act on this proposal by May 1, 2001.

By itself, however, the Commission can contribute only a small part of the solution to today's energy problems. A more comprehensive and permanent solution requires the involvement of the states and other federal agencies and departments. I am encouraged by all of the hard work and effort undertaken in recent months by the State of California and other Western states. The issues are difficult and the stakes are high. While reasonable minds can differ over the appropriate solutions to these problems, the Commission is committed to resolving these problems deliberatively.

An attachment to my testimony provides details on the Commission's major actions concerning California's electricity markets, particularly the Commission's original orders approving California's restructuring plan and recent Commission orders or decisions relating to California's markets, including enforcement actions.

II. How Did We Get Into This Situation?

A. Legislative Design

The State of California has been widely questioned for its restructuring legislation (A.B. 1890), enacted in 1996. While mistakes were made, California is to be commended for realizing that consumers are better off if supply and pricing decisions are based on market mechanisms, not bureaucratic fiat. The premise of this legislation is that consumers will enjoy lower rates and increased service options, without compromising reliability of service, if electricity providers are motivated to serve by market forces and competitive opportunities.

There were two major flaws in California's market design. First, the three utilities were forced to divest almost half of their own generation, and buy and sell power exclusively through the spot markets of the California Power Exchange (PX). This prevented the utilities from hedging their risks by developing a portfolio of short-term and long-term energy products. Second, the State mandated a retail rate reduction and freeze, eliminating any incentives for demand reduction, discouraging entry by competitors for retail sales and, more recently, threatening the financial health of the three utilities by delaying or denying their recovery of billions of dollars in costs incurred to provide service to retail customers.

However, California's situation does not demonstrate the failure of electricity competition. To the contrary, it demonstrates the need to embrace competition fully, instead of tentatively. Other states, such as Pennsylvania, have been successful in implementing electricity competition. California needs to move forward on the competitive path it has chosen, allow new generation and transmission to be sited and built, and allow its citizens to benefit from the lower rates, higher reliability, and wider variety of service options that a truly competitive marketplace can provide.

B. Other Factors

Until last year, California's spot market prices were substantially lower than even California's mandated rate freeze level. This allowed the California utilities to pay down billions of dollars of costs incurred during cost-of-service regulation. However, several events resulted in higher spot electricity prices beginning last summer. Those events included one of the hottest summers and driest years in history, as well as several years of unexpectedly strong load growth. Other factors influencing prices recently include:

- Unusually cold temperatures earlier this winter in the West and Northwest;
- California generation was unavailable to supply normal winter exports to the Northwest;
- very little generation was added in the West, particularly in California, Washington and Oregon, during the last decade;
- environmental restrictions limited the full use of power resources in the region;
- scheduled and unscheduled outages, particularly at old and inefficient generating units, removed large amounts of capacity from service; and
- natural gas prices increased significantly, due to higher commodity prices, increased gas demand, low storage, and constraints on the delivery system.

Taken together, these factors demonstrate that the present problems in electricity markets are not just "California" problems. Normal export and import patterns throughout the West have been disrupted. Reserve margins throughout the West are shrinking. Already this winter, when the demand for electricity is relatively low, Stage Three emergencies in California have become commonplace.

III. The Commission Has Taken Important Steps to Help

These problems require bold and decisive action. Both the federal government and state governments have critical roles to play in promoting additional energy supply and deliverability and decreasing demand. Through its authority to set rates for transmission and wholesale power and to regulate interstate natural gas pipelines and non-federal hydroelectric facilities in interstate commerce, the Commission can take a range of measures to promote a better balance of supply and demand, but its jurisdiction is limited. The Commission can set pricing policies which encourage entry, but it is state regulators that have siting authority for electric generation and transmission facilities, as well as authority over local distribution facilities (both for electricity and natural gas). These authorities can go a long way in improving the grid for both electricity and natural gas. More importantly, state regulators have the most significant authorities to encourage demand reduction measures, which can greatly mitigate the energy problems in California and the West.

A. Promoting Market Stability

In an order issued on December 15, 2000, the Commission adopted a series of remedial measures designed to stabilize wholesale electricity markets in California and to correct wholesale market dysfunctions. The Commission recognized that the primary flaw in the California market design was the requirement for the three California utilities to buy and sell solely in spot markets. The Commission concluded that the foremost remedy was to end this requirement and allow the utilities, first, to use their own remaining generation resources to meet demands and, second, to meet much of their remaining needs for power through forward contract purchases. This measure freed up 25,000 MW of generation that the utilities owned or controlled, which could be used directly to serve their load without having to sell it into the PX and buy it back at a much higher spot price. Our action returned to California the ability to regulate over one-half of its peak load requirements.

B. The Commission's Latest Efforts

Earlier this month, the Commission took further steps to mitigate prices in California, specifically the prices charged in California's spot markets during Stage Three emergencies in January of this year. After examining prices charged in these periods, the Commission identified many transactions that warranted further investigation. The Commission required these sellers to either refund certain amounts (or offset these amounts against amounts owed to them) or provide additional information justifying their prices. Specifically, the Commission required refunds or offsets of approximately $69 million dollars, or all prices charged during Stage Three Emergency hours in excess of $273 per megawatthour. This analysis seeks to use a proxy price based on the market clearing price that would have occurred had the sellers bid their variable costs into a competitive single price auction.

The California Independent System Operator (ISO) and the California Electricity Oversight Board ("California parties") had asked the Commission to require larger refunds. However, the Commission explained the difference between their approach and the Commission's. First, they included over $170 million for refunds from non-public utility sellers, such as the Los Angeles Department of Water and Power. The Commission has no authority to order refunds from these sellers. Second, they included refunds for sales during all hours of January; the Commission limited its approach to Stage Three Emergency hours, when the supply-demand imbalance is most severe and sellers know their power is most needed. Third, they used a pay-as-bid approach instead of the Commission's proxy market clearing price approach and they used prices only ten percent above variable costs. Finally, they included refunds for December 2000; the Commission will address the December transactions in a separate order. In sum, the Commission's approach fully protects consumers from possible exercises of market power during emergency conditions while still providing clear price signals encouraging sorely needed new generation and load reductions.

Also this month, the Commission's staff issued a proposal on how the Commission should monitor and mitigate prices in California's wholesale spot power markets in the future. This proposal is based on monitoring and mitigating prices on a before-the-fact basis, instead of through after-the-fact refunds. Comments on the staff's proposal are due on March 22nd. After receiving and considering public comment, the Commission intends to implement appropriate changes to its current market monitoring and mitigation requirements by May 1st.

Just last week, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and the West, to the extent of its jurisdictional authority. The Commission implemented several measures immediately, including:

- streamlining filing and notice requirements for various types of wholesale electric sales, including sales of on-site or backup generation and sales of demand reduction;

- extending (through December 31, 2001) and broadening regulatory waivers for Qualifying Facilities under the Public Utility Regulatory Policies Act of 1978, enabling those facilities to generate more electricity;

- expediting the certification of natural gas pipeline projects into California and the West; and,

- urging all licensees to review their FERC-licensed hydroelectric projects in order to assess the potential for increased generating capacity.

The Commission also proposed, and sought comment on, other measures such as incentive rates and accelerated depreciation for new transmission facilities and natural gas pipeline facilities completed by specified dates, blanket certificates authorizing construction of certain types of natural gas facilities, and greater operating flexibility at hydroelectric projects to increase generation while protecting environmental resources.

Finally, the Commission stated its intent to hold a one-day conference with state commissioners and other state representatives from Western states to discuss price volatility in the West, as well other FERC-related issues recently identified by the Governors of Western States. The conference will be held in Boise, Idaho, on April 6th.

Also last week, the Commission ordered two utilities (AES Southland, Inc., and Williams Energy Marketing & Trading Company) to show why they should not be found to have increased power prices in the California market and potentially compromised the reliability of the transmission network in violation of tariffs on file under the Federal Power Act. The Commission stated that the two utilities extended outages at certain generating facilities from April 25 through May 11, 2000. These facilities are owned by AES, which sells the power to Williams for resale. The shut down forced the ISO to purchase power from other generation units also owned by AES, and whose power is also resold by Williams, at prices greatly in excess of the market price or the variable costs of operating the units. Williams and AES must explain why either or both should not make refunds totaling $10.84 million. Williams also must explain why it should not be precluded from receiving a market-based rate for AES' Southern California facilities for one year.

IV. Price Caps Would Make Things Worse

Some advocate price caps or cost-based limitations as a temporary way to protect consumers until longer-term remedies alleviate the supply/demand imbalance. The issue of price caps in the West has been raised on rehearing of the Commission's order of December 15, 2000, and, accordingly, is pending before the Commission. For this reason, I cannot debate the specific merits of price caps for California or the West. However, I will reiterate briefly the views I have stated publicly on this issue.

As a general matter, price caps do not promote long-term consumer welfare. Price caps will not increase energy supply and deliverability or decrease demand. Instead, price caps will deter supply and discourage conservation. At this critical time, legislators and regulators need to do everything they can to promote supply and conservation, not discourage them.

This viewpoint is based on experience, not just economic theory. The summer of 1998 illustrates the point. Then, wholesale electricity prices in the Midwest spiked up significantly. The Commission resisted pleas for immediate constraining action, such as price caps. Subsequently, suppliers responded to the market-driven price signals, and today the Midwest is not experiencing supply deficiencies.

In short, price caps can have long-term harmful effects because they do not provide appropriate price signals and may exacerbate supply deficiencies. Supply and demand cannot balance in the long-term if prices are capped.

In the context of California, today we have market prices and barely adequate supplies. If we reduce prices below market levels, supplies will go elsewhere, risking greater reliability problems. Price caps will only aggravate the supply-demand imbalance.

In addition, capping prices based on individual seller costs likely would require lengthy, costly and contentious evidentiary hearings. Litigating such a rate case for one seller requires a significant commitment of resources. Concurrently litigating such cases for scores of sellers in the West would be overwhelming both for the Commission and the industry. Moreover, neither buyers nor sellers would be sure of the prices until the conclusion of this litigation. This delay in price certainty would be unfair to customers and discourage new investments by suppliers.

Many leaders share these views. In a letter to the Secretary of Energy, dated February 6, 2001, eight Western governors expressed their opposition to regional price caps. They explained that "[t]hese caps will serve as a severe disincentive to those entities considering the construction of new electric generation, at precisely the time all of us – and particularly California – are in need of added plant construction."

In the face of the current challenges, we all must have an open mind to any proposals that may mitigate the energy problems in the West. I remain unconvinced that price caps will help solve the problems and I do not believe they are in the long-term interest of consumers. Price caps will only serve to drive investment and supplies to those markets without caps, harming consumers in the long-term.

V. Conclusion

The Commission remains willing to work in a cooperative and constructive manner with other federal and state agencies. The Commission will continue to take steps that, consistent with its authority, can help to ease the present energy situation without jeopardizing longer-term supply solutions. As long as we keep moving toward competitive and regional markets, I am confident that the present energy problems, while serious, can be solved. I am also confident that market-based solutions offer the most efficient way to move beyond the problems confronting California and the West.

Thank you.

Commission Staff Summary of
Major Orders On California Restructuring

I. Overview

The Commission began addressing the California restructuring in 1996. Initially, the Commission's approach was largely deferential to State decisions affecting wholesale power market matters within FERC's jurisdiction. However, as problems started surfacing and then heightened significantly in the Summer of 2000, the Commission no longer deferred to State decisions affecting matters within the Commission's jurisdiction. The resources devoted by the Commission to California's restructuring were significant from the beginning and, in recent months, have increased steadily. In all, the Commission has issued over 80 orders involving California's restructuring, including over 30 amendments to the ISO tariff and 25 amendments to the PX tariff. This year alone, the Commission has issued over 20 orders involving California's wholesale power markets.

The following sections address the most significant of the Commission's California initiatives, without citations to concurring or dissenting statements of individual Commissioners.

II. Initial Authorization of California Restructuring

California's efforts to restructure its electric industry began in 1994. Extensive hearings and negotiations in proceedings before the California Public Utilities Commission (CPUC) resulted in a final CPUC restructuring order issued in December 1995. The California legislature took up the subject next and this led to the unanimous enactment of Assembly Bill 1890 (AB 1890) in September 1996. FERC noted in its subsequent orders that California was the first state to enact a comprehensive restructuring plan and made it clear that FERC would give great weight to the decisions made in the state legislation.

The major features of AB 1890 included: (1) creation of an ISO and PX by January 1998 and simultaneous authorization of retail competition; (2) creation of the California Electricity Oversight Board with members appointed by the Governor and legislature; (3) a competitive transition charge for the recovery of the traditional utilities' stranded costs; and (4) a ten percent rate reduction for residential and small customers, and a rate freeze for all retail customers.

At California's request, the Commission considered the various aspects of California's restructuring in stages, resulting in a series of FERC orders as details were added to the restructuring plans.

On November 26, 1996, the Commission accepted the filings of Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SoCal Ed), and San Diego Gas and Electric Company (SDG&E) (collectively, Companies) seeking approval for those aspects of the restructuring subject to FERC's jurisdiction. 77 FERC ¶ 61,204 (1996). The Companies' proposals reflected the CPUC's orders and AB 1890. The Commission's order approved the transfer of operational control of transmission facilities to the ISO, the overall framework for establishment of the ISO and PX, and the jurisdictional split between the transmission and local distribution facilities of the utilities. The Commission largely approved the California market design as filed and provided guidance on matters that needed further support by the companies in order to gain final approval under the Federal Power Act (FPA).

However, the Commission determined that it could not accept the proposed role of the Oversight Board in the governance or operations of the ISO and PX, or appellate review of ISO board decisions, because the Oversight Board's role was not limited to matters subject to State jurisdiction and concerned matters within the Commission's exclusive jurisdiction. Thus, the Commission did not approve a permanent role for the Oversight Board. Instead, the Commission approved only an initial start-up function for the Oversight Board, to expedite the establishment of the ISO and PX initial governing boards.

In March 1997, as supplemented in August 1997, the ISO and PX submitted Phase II of the restructuring proposal, including organizational and governance documents, an Operating Agreement and Tariff for each, a Transmission Control Agreement, and other materials and explanations previously required by the Commission. The Commission addressed these filings in an order dated October 30, 1997, conditionally authorizing limited operation of the ISO and PX. 81 FERC ¶ 61,122 (1997). The Commission reiterated, and provided additional guidance on, its findings on the Oversight Board.

In that order, the Commission also addressed the Companies' requests for market-based rates, which they filed at the direction of the CPUC. The Commission accepted the Companies' market-based rates, in part, due to the plans of PG&E and SoCal Ed to divest significant amounts of their generation. 81 FERC at 61,546-47.

III. Early Actions On Price Caps

Shortly after the ISO and PX commenced operations on March 31,1998, prices for ancillary services in the ISO's markets increased significantly. See AES Redondo Beach, L.L.C., et al., 84 FERC ¶ 61,046 (1998), order on reh'g, 85 FERC ¶ 61,123 (1998) (October 28, 1998 Order), order on further reh'g, 87 FERC ¶ 61,208 (1999) (May 26, 1999 Order), order on further reh'g, 88 FERC ¶ 61,096 (1999), order on further reh'g, 90 FERC ¶ 61,148 (2000). The ISO proposed price caps as a solution. In an order issued July 17, 1998, the

Commission authorized the ISO for an interim period to reject bids in excess of whatever price levels it believed were appropriate for the ancillary services it procures. On rehearing, the Commission explained that, as the procurer of ancillary services, the ISO had the discretion to reject excessive bids. The Commission also stated that a purchase price cap is not an ideal approach to operating a market and that it did not expect the cap to remain in place on a long-term basis. October 28, 1998 Order, 85 FERC at 61,463. The Commission also directed the ISO to file a comprehensive proposal to redesign its ancillary services markets. AES Redondo Beach, L.L.C., et al., 85 FERC ¶ 61,123 at 61,462 (1998).

The Commission later approved a filing by the ISO authorizing the ISO to adopt a purchase price cap for its imbalance energy market at whatever level it deemed necessary and appropriate. California Independent System Operator Corporation, 86 FERC ¶ 61,059 (1999).

In an order approving the ISO's ancillary services market redesign, the Commission allowed the ISO to retain the authority to specify purchase price caps for ancillary services and imbalance energy until November 15, 1999. May 26, 1999 Order, 87 FERC at 61,817-19. The ISO had proposed to raise and eventually eliminate existing price caps on ancillary services and imbalance energy upon the implementation of several redesign elements, but in the interim, it planned to maintain the then current $250/MWh purchase price caps. The Commission directed the ISO to eliminate the price caps by November 15, 1999, with the caveat that the ISO could file for an extension of its price cap authority if its experience with the market reforms over the summer indicated serious market design flaws still existed.

In September 1999, by direction of the ISO's Governing Board, the price caps were raised from $250 to $750. On September 17, 1999, the ISO filed proposed tariff revisions to extend for one year, until November 15, 2000, its authority to cap ancillary services and imbalance energy prices. The proposal gave the ISO the discretion to lower the price caps to $500 effective June 1, 2000, if the ISO Governing Board determined that any of three specific conditions were met. The proposal also gave the ISO discretion to lower the price caps by an unspecified amount in the event that it determined that the markets were not workably competitive. The Commission accepted the proposed tariff provisions in November 1999, giving the ISO the opportunity to complete its market redesign and to test its reforms under summer peak conditions. See California Independent System Operator Corporation, 89 FERC ¶ 61,169 (1999), reh'g pending.

IV. Developments on Governance

On November 24, 1998, the Commission found the ISO and PX not to be in compliance with its prior orders on the role of the Oversight Board. 85 FERC ¶ 61,263 (1998). The Commission denied the ISO's request to defer enforcement of its prior orders, and directed the ISO and PX to revise their bylaws to be consistent with the Commission's determinations. The Commission again provided guidance on the proper sphere of action by the Oversight Board.

On August 5, 1999, the Commission granted a petition for declaratory order by the Oversight Board. The Commission said that the modified governance structures contained in proposed state legislation would comply with federal law. Under this proposed legislation, the Oversight Board's activities were narrowed to include, e.g., an appellate function on matters affecting the general welfare of the State's electric consumers and the right to confirm only those ISO and PX board members representing end-users. This proposed legislation was subsequently enacted.

V. Last Year's Actions

On July 26, 2000, the Commission ordered a fact-finding staff investigation on technical or operational factors, regulatory prohibitions or rules (Federal or State), market or behavioral rules, or other factors affecting the competitive pricing of electric energy or the reliability of service in electric bulk power markets. The Commission directed its staff to report its findings to the Commission by November 1, 2000.

On August 23, 2000, the Commission issued an order initiating a formal hearing on the justness and reasonableness of the rates in California's spot markets. 92 FERC ¶ 61,172. This action meant that refunds could be ordered as of the refund effective date of October 2, 2000, if rates were found to be unjust and unreasonable. The investigation was initiated partly in response to a complaint by SDG&E asking for the emergency imposition of a price cap to protect consumers from extreme price increases. The Commission simultaneously instituted an investigation into whether the tariffs and institutional structures and bylaws of the ISO and PX were adversely affecting the efficient operation of competitive wholesale electric power markets in California.

On November 1, 2000, the Commission issued an order proposing measures to remedy the problems identified in a Commission Staff Report on Western Markets and the Causes of the Summer 2000 Price Abnormalities. 93 FERC ¶ 61,121. The Commission sought comment on its proposed remedies.

Beginning in mid-November, the ISO began experiencing repeated emergency conditions forcing it to serve increasingly large portions of its load through its imbalance energy market. On December 8, 2000, the ISO filed a tariff amendment seeking expedited consideration of tariff revisions to address these conditions. Most significantly, the ISO sought immediate implementation of an interim price mitigation proposal based on a concept that was proposed in the November 1 Order, rather than continuing its $250/MWh price cap, to encourage greater participation of generators in its markets. The mechanism would pay sellers their bids even if their prices exceeded that level but their bids would not set a market clearing price to be paid to all sellers in the market. The Commission approved the tariff revisions in an order issued December 8, 2000. 93 FERC ¶ 61,239.

Also on December 8, 2000, the Commission issued an order waiving certain regulations pertaining to QFs, effective for the period December 8 through December 31, 2000, to allow certain QFs to sell additional power to load located in California to help alleviate the supply-demand imbalance in California. 93 FERC ¶ 61,238.

On December 15, 2000, the Commission issued an order adopting many of the remedies proposed in its November 1, 2000 order. 93 FERC ¶ 61,294. It ordered specific short- and long-term measures to remedy the dysfunctional California bulk power markets.

First, the December 15 order eliminated the requirement for California's investor-owned utilities to sell all of their generation into and buy all of their energy needs from the PX. The buy/sell requirement resulted in an over-reliance on spot market purchases and created an excessive exposure to short-term price fluctuations. The Commission also ordered the termination of the PX's wholesale rate schedules effective as of the close of the April 30, 2001 trading day. This resulted in 25,000 megawatts of generation, either owned by or under contract to the three California utilities, being returned to the utilities for direct sales to retail customers subject to State regulation, instead of being sold to, and repurchased from, the PX.

In addition, the order addressed the problem of underscheduling, directing utilities to schedule 95 percent of their transactions in advance of real time, to reduce the reliance on the ISO's real-time market. A penalty was imposed for loads that exceed the prescheduled amount by more than five percent.

The order also established a $150 per MWh breakpoint mechanism intended to help ensure just and reasonable rates from January 1, 2001 until May 1, 2001, until long-term measures could be put in place. The single price auction was modified so that bids above $150 per MWh would not set the market clearing prices paid to all bidders. Public utility sellers (primarily the investor-owned utilities) that bid above this breakpoint were required to file weekly transaction reports with the Commission. Sellers were made subject to potential refund liability if the Commission finds they sold power at prices that were not just and reasonable.

The order directed Commission staff to develop a comprehensive market monitoring and mitigation program to replace the $150/MWh breakpoint mechanism and to be in place by May 1, 2001. The order also rejected calls for price caps or cost-based rates, stating that the remedies adopted by the Commission were "designed to help alleviate the extreme high prices being borne by Californians, but also to ensure that sellers continue to have incentives to sell into California and sufficient incentives to build sorely needed new generation and transmission necessary to provide reliable service in the future."

VI. This Year's Actions

On January 8, 2001, the Commission issued an order clarifying the December 15 order. 94 FERC ¶ 61,005. The Commission reiterated a directive for the PX to terminate its wholesale rate schedules effective April 30, 2001, but clarified that the order was not intended to preclude the PX from continuing its market for bilateral forward contracting.

On January 29, 2001, the Commission issued an order finding the PX in violation of its December 15 order by not implementing the $150 per MWh breakpoint, and it required immediate recalculation of wholesale rates by the PX. 94 FERC ¶ 61,085.

On February 1, 2001, the Commission staff issued a report on generating plant outages in California, focusing on whether unplanned maintenance or outages occurred to raise prices. Staff did not find evidence suggesting that the companies audited were scheduling maintenance or incurring outages in an effort to influence prices. Rather, the report concluded that the types of problems encountered (i.e., turbine seal leaks) are common considering that these facilities had been operating above normal levels and were 30 to 40 years old.

Also on February 1, 2001, the Commission Staff released a study looking at power markets in the Northwest during November and December 2000. The report found, in sum, that the Northwest power markets saw increased demand through the 1990s, without increased generation capacity. In November and December of 2000, the market was driven by extreme cold, high natural gas prices and low storage levels, and by low water, precipitation and stream flow levels. These conditions were made worse by a large number of plant outages and environmental constraints, and a general atmosphere of market uncertainty.

On February 14, 2001, the Commission issued an order addressing the creditworthiness tariff provisions proposed by the ISO. 94 FERC ¶ 61,132. The credit ratings of PG&E and SoCal Ed had deteriorated significantly, resulting in the inability of the utilities to meet the existing creditworthiness standards. The ISO proposed to amend its tariff to lower the creditworthiness standards. The order accepted the ISO's amendment for purposes of allowing PG&E and SoCal Edison to continue to schedule their own generating resources to serve their load. The order held, however, that the utilities could continue purchasing through the ISO from third-party suppliers only if they obtained financial backing from creditworthy counterparties.

On March 9, 2001, the Commission directed 13 jurisdictional sellers of power into the ISO and PX short-term markets in January to either make refunds for certain power sales (or offsets against accounts receivables) or provide further justification of their prices. 94 FERC ¶ 61,245. The Commission reached this decision after reviewing generators' transaction reports and reports by the ISO and PX, and finding that certain transactions exceeded a Commission-determined market-clearing proxy price for Stage 3 emergency hours in January. The proxy price was based on data including average natural gas prices, average NOx allowance costs, and variable operation and maintenance costs.

Public utility sellers with transactions above the January proxy price of $273/MWh must notify the Commission on or before March 23, 2001 that they will either: (1) refund the excessive amounts or offset such amounts against any amounts due or owed to them; or, (2) supply further data to justify transactions above this level. The Commission will determine a proxy clearing price for each month through April 2001. Commission staff will issue notice of the proxy price within 15 days of the end of each month.

Also on March 9, 2001, the Commission's staff issued a proposal on how the Commission should monitor and mitigate prices in California's wholesale spot power markets in the future. This proposal is based on monitoring and mitigating prices on a before-the-fact basis, instead of through after-the-fact refunds. Comments on the staff's proposal are due on March 22nd. After receiving and considering public comment, the Commission intends to implement appropriate changes to its current market monitoring and mitigation requirements by May 1st. These changes will supersede the $150 breakpoint mechanism currently in effect.

On March 14, 2001, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and the West. The Commission implemented certain measures immediately. For example, the Commission streamlined regulatory procedures for wholesale electric power sales, extended (through December 31, 2001) and broadened regulatory waivers for Qualifying Facilities under the Public Utility Regulatory Policies Act of 1978, authorized market-based rates for sales of on-site and back-up generation and sales of demand reductions, expedited the certification of natural gas pipeline projects into California and the West, and urged all licensees to review their FERC-licensed hydroelectric projects in order to assess the potential for increased generating capacity. The Commission also proposed, and sought comment on, other measures such as incentive rates for new transmission facilities and natural gas pipeline facilities completed by certain dates this year or next. The Commission also announced that it intends to meet with state regulators this Spring.

Also on March 14, 2001, the Commission ordered two utilities (AES Southland, Inc., and Williams Energy Marketing & Trading Company) to show why they should not be found to have inflated power prices in the California market and potentially compromised the reliability of the transmission network in violation of tariffs on file under the Federal Power Act. 94 FERC ¶ 61,248. The Commission stated that the two utilities extended outages at certain generating facilities from April 25 through May 11, 2000. These facilities are owned by AES, which sells the power to Williams for resale. The shut down forced the ISO to purchase power from other generation units also owned by AES, and whose power is also resold by Williams, at prices greatly in excess of the market price or the variable costs of operating the units. Williams and AES must explain why either or both should not make refunds totaling $10.84 million. Williams also must explain why it should not be precluded from profiting from outages of AES' Southern California facilities for one year.